Supreme Court of the United States

No. 814

BRIEF IN OPPOSITION FOR THE RESPONDENTS PRODUCERS INC TRAYLOR BROS INC INDUSTRIAL CONTRACTORS INC

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1960.

No. 814.

REX SCHEPP, AND BENJAMIN F. SHEPP,

Petitioners,

vs.

PRODUCERS, INC., TRAYLOR BROS., INC., INDUSTRIAL CONTRACTORS, INC., CARL WOLF, SMITH AND BUTTERFIELD, INC., RED SPOT PAINT AND VARNISH COMPANY, INC., DOUGLAS H. McDONALD, DOUGLAS H. McDONALD, TRUSTEE, AND EVANSVILLE TELEVISION, INC.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF IN OPPOSITION FOR THE RESPONDENTS PRODUCERS, INC., TRAYLOR BROS., INC., INDUSTRIAL CONTRACTORS, INC.

OPINIONS BELOW

The opinion of the District Court has not been reported. The opinion of the Court of Appeals for the Seventh Circuit is reported at 286 F. (2d) 65 (1961).

JURISDICTION

The jurisdictional requisites are adequately set forth in the Petition.

QUESTIONS PRESENTED.

1. Whether the District Court and Court of Appeals were clearly erroneous in their concurrent finding that the Petition for Reorganization was filed in good faith.

2. Whether the provision of 11 U. S. C. A. Section 526 which authorizes the filing of a Petition for Reorganization by "three or more creditors" was satisfied.

3. Whether a timely appeal was perfected from the injunctive order of the District Court.

STATUTE INVOLVED.

The statutes involved are adequately set forth in the Petition.

STATEMENT.

Rex Schepp and Benjamin F. Shepp, stockholders in Evansville Television, Inc., seek by their Petition for Certiorari to obtain review by this Court of an order of the District Court, approved by the Court of Appeals, in a Chapter X Bankruptcy Reorganization proceeding, 11 U. S. C. A. Section 501 *et seq.*; which approved and declared filed in good faith a Petition to Reorganize the subject corporation.

The Petitioners, as objecting stockholders, also seek review by this Court of the ruling of the Court of Appeals that certain notices of appeal of an order of injunction and an order of allowance were not timely.

The Petition for Reorganization of the subject corporation, under Chapter X, was filed in the District Court by the three Respondents herein. There were three intervening creditors which petitioned to join, and were permitted to join, as Petitioning Creditors seeking reorganization. Affidavits were filed by Petitioning Creditors to conform

with Bankruptcy General Order 5(2). Two of these affidavits are questioned by the Petitioners herein as to their accuracy. The corporation filed an answer consenting to its reorganization. The Petitioners herein, as objecting stockholders, filed a controverting answer to the Petition. After the appointment of a Trustee the District Court granted an injunction enjoining shareholders from holding stockholders' meetings. The District Court, after hearing evidence, approved the Petition for Reorganization and made findings of fact including findings that the debtor corporation was insolvent (R. Ap. I, p. 83) (appendix references herein conform with those used in the Petition for Certiorari), that the reorganization petition was filed in good faith (R. Ap. I, p. 84), that neither the debtor nor its directors, stockholders, attorneys, agents, officers or employees at any time committed "any wrong or fraudulent acts" (R. Ap. I, p. 84), that the Petitioning Creditors constituted three separate legal entities (R. Ap. I, p. 81), and that the intervening creditors were separate and distinct and, as Petitioning Creditors, constituted three creditors (R. Ap. I, p. 81). These findings, together with other questions, were appealed by the Petitioners to the Court of Appeals for the Seventh Circuit and were there upheld (pp. 40, 41, Petition for Certiorari). The injunction against the holding of further stockholders' meeting was also appealed, and that appeal was dismissed by the Court of Appeals on the ground that it was not timely filed (Opinion, Petition for Certiorari, p. 28).

ARGUMENT.

I.

There Is No Conflict of Decision.

The objecting stockholders, in their Petition for Certiorari, assert that the holdings of the Court of Appeals and the District Court are in conflict with certain United States Supreme Court cases. It is their argument that the consenting answer of the debtor, and the fact that certain directors of the debtor had an interest in the creditor corporations, prevented the proceeding herein from being in good faith. The cases they rely on, to establish the conflict, are clearly distinguishable and there is not even a conflict of principle. These cases are:

(1) *Pepper* v. *Litton*, 308 U. S. 295 (1939). In *Pepper* one of the directors of the debtor corporation milked the debtor of assets to pay "what was not an honest debt of the corporation", 308 U. S. 295, 301, in what was a "planned and fraudulent scheme". 308 U. S. 295, 312. This case does not condemn dealings by directors with their corporations. It merely says that such dealings must be fair and in good faith.

(2) *Geddes* v. *Anaconda Copper*, 254 U. S. 590 (1920). Here a corporate director sold assets of his corporation to another of his corporations at what both the District Court and the Court of Appeals found to be an inadequate price, and in the opinion in the *Geddes* case there is no restriction on dealings between corporations with boards having common members. There is merely a requirement that such dealings be fairly conducted.

(3) *Harkin* v. *Brundage*, 276 U. S. 36 (1927). In this case there was overt fraud in the concealment of a pending state court receivership from the Federal District Court, and, moreover, this was not a bankruptcy case. It was an equity receivership and the question was whether the Federal or State court should have jurisdiction of the receivership *res*.

These cases merely announce the well-known principles that Fraud is Wrong (*Harkin* v. *Brundage*) and that directors should deal fairly and in good faith with their corporations (*Pepper* v. *Litton* and *Geddes* v. *Anaconda*). None of them is in conflict with the concurrent findings herein that the directors of the debtor acted fairly and in good faith and without fraud. Indeed, unless this Court finds error in the concurrent finding of good faith herein (discussed *infra* at pages 6-10) there is absolute harmony between the instant case and the cases characterized by the objecting stockholders as conflicting.

II.

There Is No Important Question of Federal Law.

The objecting stockholders have, in their Petition for Certiorari, asserted that certain questions are important questions of Federal law which have not been, but which should be, settled by this Court. Nowhere in the Petition is there any reason given to support the conclusion that the questions are important. These questions, deemed important in the Petition, turn more or less on the unique facts of this case; *e.g.*, the question of the import of the two affidavits, urged as "important" on page 17 of the Petition, turns on the meanings of the phrase "personal knowledge" and the word "paid" and their significance in affidavits under Bankruptcy General Order 5(2). (See

discussion at pages 6-8, *infra* herein.) It is submitted that this question and the other questions characterized as "important" in the Petition are important to but few other than the parties herein and do not warrant certiorari review by this Court.

III.

The Decision Below Is Clearly Correct.

The Petitioners for Certiorari herein have argued that this Court should review the holding of the Court of Appeals because that Court committed error in upholding the District Court's findings of fact that (1) The reorganization petition was filed in good faith, and (2) there was the required minimum of three creditors; and they further urge that the Court committed error in dismissing the injunctive order because its appeal was not timely.

The Reorganization Petition was filed in good faith. It is, of course, "well established that this court will not disturb findings of fact made by a district court in equity concurred in by the circuit court of appeals, except in case of clearest error (citing 10 U. S. Supreme Court cases)", *Charleston, S. C. Mining & Mfg. Co.* v. *U. S.*, 273 U. S. 220, 223 (1927). It is equally well established that District Courts sitting on bankruptcy matters are courts of equity. *Pepper* v. *Litton*, 308 U. S. 295, 308 (1939). The conclusion of good faith was a finding of fact (R. Ap. I. p. 84). Thus, the standard to be applied to the "good faith" question is whether the Court of Appeals committed the clearest error.

In attempting to show the error of the Court of Appeals the Petitioners have stressed that the filing of certain affidavits by the Petitioning Creditors constituted bad faith. Bankruptcy General Order 5(2) requires an affidavit stating that claims were not obtained for the purpose of

filing the Reorganization Petition. One Denis Stallings executed such an affidavit as an officer of Producers, Inc., one of the Petitioning Creditors. It is not argued in the Petition for Certiorari, nor is it a fact, that Producers, Inc. obtained its claim for the purpose of filing the reorganization petition. Rather, the substance of the argument of the Petitioners is merely that Stallings' affidavit stated that it was executed on personal knowledge, and that the affiant did not have personal knowledge of the facts sworn to, although such facts are admittedly true. The affiant, as Vice-President of Producers, Inc., had knowledge based on information from the attorneys and accountant of the Petitioning Creditors, including Producers, Inc., and these sources had intimate knowledge of the information contained in the affidavit. It is submitted that a corporate officer obtaining such information from such sources could reasonably consider such knowledge to be "personally known" to him. Moreover, G. O. 5(2) affidavits are not required to be on personal knowledge. But it is not the purpose of Respondents to argue the importance of the fact that the affiant had personal knowledge. The significant point here is that even assuming *arguendo* that he did not have personal knowledge, as a technical legal or semantic matter, his mistake is not such as to taint this entire reorganization proceeding as being filed in bad faith.

The Petitioners for Certiorari seek to defeat this proceeding on grounds of bad faith as to another technical objection to another G. O. 5(2) affidavit, the affiant in which was one Ferris E. Traylor. The affiant swore that one of the Petitioning Creditors, a corporation, "paid" $300,000.00 for an account, and the Petitioners cry fraud and perjury because the word "paid" referred to a book credit and not to an exchange of cash. It is, of course, fundamental law that an obligation may be "paid" or

satisfied by a promise of payment or other thing of value as well as by cash. *Smith* v. *Truehart*, N. Y. Supreme Court, 223 N. Y. S. 481, 483 (1927); *State* v. *Lorain*, 22 Ohio Dec. 392, 393, 12 Ohio N. P. N. S. 636. Once more, the Petitioners attempt to balance a charge of bad faith as to the entire proceeding upon an assertion that a G. O. 5(2) affidavit contains a false statement when the truth or falsity of the affidavit itself is a matter for legal and semantic disputation.

In still another attempt to impute bad faith to the filing of the Reorganization Petition, the Petitioners herein argue that there was a collusive purpose for instituting the reorganization proceedings, but there is a serious lacuna in the Petition for Certiorari in that there is a studied avoidance of the financial plight of the debtor corporation at the time of the institution of the reorganization proceedings. In fact, the ability of the debtor to obtain funds by capital contributions or loans had been exhausted (R. Ap. II, p. 14). For two years prior to the filing of the Petition banks and individuals had been approached for loans unsuccessfully (R. Ap. II, pp. 14, 53). If the debt and the capital structure of the debtor were not revised, necessary funds would be unavailable (R. Ap. II, p. 14). The debtor never had an annual period in which it experienced a profit (R. Ap. II, p. 68). The reorganization was instituted December 19, 1958. Up to and including December 22, 1958, the debtor had sustained an operating deficit of $659,383.78 (R. Ap. II, p. 107), and on that date the books of the debtor reflected total assets of $752,320.37, of which $110,790.34 were current assets (R. Ap. II, p. 105), and total liabilities of $911,204.15 of which $632,798.08 were current liabilities (R. Ap. II, p. 106). On the basis of these facts, it seems almost self-evident that a readjustment of the holdings of creditors and stockholders was required if the debtor was to continue as an operating business. On the basis of this, and

related evidence, the District Court found, and the Court of Appeals upheld, that the debtor was insolvent and the Reorganization Petition was filed in good faith.

The Petitioners for Certiorari have told this Court that there was coercion to force the Petitioners as majority stockholders to sell their holdings, that the threat of filing this reorganization proceeding was a part of that coercion; and therefore, they argue, the Reorganization Petition was filed in bad faith. There were negotiations for the purchase of stock, but the Petitioning Creditors certainly should not be chastened for attempting to save the debtor corporation from financial destruction by means other than a potentially costly reorganization proceeding. Also, the reorganization proceeding was not filed until the possible filing had been disclosed to the Petitioners. This they characterized in their Petition as using the proceeding as a club to coerce them. In their concern for what they claim to be persecution, the objecting stockholders willingly ignore the financial status of the debtor.

Also, the objecting stockholders argue that the consenting answer, filed in the reorganization by the debtor corporation, was an act of bad faith. They base this on the ground that certain directors of the debtor who voted for such consenting answer were interested in corporations having claims against the debtor. In Indiana, in accordance with the general rule, dealings between directors and their corporations are not forbidden, and are not even voidable, in the absence of a clear showing of unfairness or fraud. *Wainwright* v. *P. F. & H. M. Roots Co.*, 176 Ind. 682, 97 N. E. 8. In the instant case there was no fraud, unfairness, or concealment, and, as recognized by the Court of Appeals, there were ample *bona fide* reasons for the debtor's consenting answer in the reorganization (Opinion, in Petition for Certiorari at page 34). Moreover, there was an express finding of fact in the District Court that none of the

directors of the debtor had committed any wrong or fraudulent acts (R. Ap. I, p. 84).

Failure to hear controverting answer was not error. The objecting stockholders have represented to this Court in their Petition that there was error by the District Court in failing to hear the controverting answer of objecting stockholders before entering an order approving the Reorganization Petition. It is not necessary to argue law on this point because the objecting stockholders have misstated the facts.

As a matter of fact, at the hearing of December 31, 1958, one of the objecting stockholders, B. F. Shepp, appeared by attorney and the other, Rex Schepp, appeared *pro se*, and Rex Schepp and that attorney, George Barnett, on behalf of B. F. Shepp, expressly agreed to the entry of "whatever order" the Court proposed to enter with relation to "the good faith and appointment of a Trustee" providing it was with the understanding that Rex Schepp had a right to be heard on his controverting answer at a later date (R. Ap. II, p. 15).

The statutory requirement of a minimum of three creditors was satisfied. There were three original Petitioning Creditors. The objecting stockholders, before the approval of the Petition for Reorganization, argued that the Petitioning Creditors could not be counted as three because they were corporations having interlocking ownership and directorate structures. Thereafter, three additional creditors petitioned to intervene, and, because of this objection, they were permitted to intervene as intervening petitioning creditors.

The objecting stockholders contend that these intervenors may not be included in computing the number of Petitioning Creditors. The law is clearly to the contrary. *Collier on Bankruptcy* states:

"This is not to say that a creditor may not be permitted to intervene in support of an involuntary petition for reorganization (f. n. citing cases). Section 207 allows intervention by a properly qualified creditor (f. n.) in the discretion of the judge upon cause shown (f. n. 7). If intervention is authorized for the purpose of joining in the petition, the intervening creditor is a petitioning creditor for all purposes, and must be counted in determining whether or not the necessary three petitioners exist (f. n.)" 6 *Collier on Bankruptcy* (14th ed.) 1424-5.

Again dealing with the factual situation at hand in this case, *Collier*, as Footnote 7 supplementing the passage just quoted, continues:

"Where a reorganization petition has been filed by only three creditors, one of which is not properly qualified under Section 126, * * * so that a dismissal is necessitated, and another creditor who is properly qualified seeks to intervene in support of the petition, it would be an unusual case in which a refusal of such intervention would not constitute an abuse of discretion." 6 *Collier on Bankruptcy* (14th ed.) 1425.

It should be noted that the Second Circuit case on which the objecting stockholders rely in this regard, *Rudnick* v. *Coney Island Boardwalk Corp.*, 181 F. (2d) 775 (C. A. 2d, 1950) did not hold, as they urge, that creditors and stockholders may not intervene. The case does hold that the court will not recognize the intervention of an attorney on behalf of creditors, where there is no reason or cause for the intervention, in setting the amount of allowance for his attorney's fee.

U. S., ex rel. Texas Portland Cement Company v. *McCord*, 233 U. S. 157 (1914), relied on by the objecting stockholders, is wholly inapplicable because: (1) the petition to interevene in that case was not timely filed, being more than a year after the commencement of the action; (2) the case

involved a Federal Act concerning suppliers of work and labor to the government and the decision turns on specific statutory language; (3) no bankruptcy or Chapter X proceeding was involved; and (4) the Court held that the purported intervention was not an intervention at all, but merely an appearance in the original action.

It is not admitted by the Respondents that this proceeding would lack three Petitioning Creditors if the intervenors were not counted as Petitioning Creditors. The argument that the three corporations constituting the original Petitioning Creditors should be considered as only one creditor because of their similar (not identical) shareholders and officers is unconvincing in light of the leading case of *Watertown Paper Company*, 169 Fed. 252, 255-6 (C. C. A. 2d, 1909), which establishes the separate existence of corporations in bankruptcy matters where stockholders are largely the same and the same management exists.

The Court of Appeals did not commit error in refusing to review the injunctive order issued by the District Court. The Court of Appeals refused to review the order of the District Court enjoining shareholders' meetings because the appeal was not timely filed. In so doing it relied on well-established precedent (see Opinion, Petition for Certiorari, pp. 37-38). However, it is not necessary to discuss here the timeliness of the appeal. In the first place there was not error in the District Court in granting the injunction because it was within the broad discretion of that court. *South State Street Bldg. Corp.*, 140 F. (2d) 363, 366 (C. C. A. 7th, 1943); *Public Service Holding Corp.*, 141 F. (2d) 425 (C. C. A. 2d, 1944).

Perhaps even more significant is the fact that the objecting shareholders did, contrary to the command of the injunction, hold a meeting which they characterized as a stockholders' meeting (R. Ap. I, p. 61, and R. Ap. II, pp.

72, 73), and thus the question of error is moot because the objecting stockholders were not prejudiced.

The question of timeliness of appeal of allowances was correctly decided by the Court of Appeals. The objecting stockholders argue that the Court of Appeals erred in holding that the appeal of allowances was not timely. It is obvious that this question is moot unless Certiorari is granted on other grounds, as is admitted by implication on page 14 of the Petition for Certiorari. However, it is submitted that the same authorities relied on by the Court of Appeals in dismissing the appeal of the injunctive order as untimely (Opinion, pp. 37, 38, Petition for Certiorari) are equally applicable here.

CONCLUSION.

For the foregoing reasons, it is respectfully submitted that this Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

JOHN E. EARLY,
915 Old National Bank Bldg.,
Evansville, Indiana,
Counsel for Respondents Producers, Inc., Traylor Bros., Inc., Industrial Contractors, Inc.

Of Counsel:
LEONARD GESAS,
MICHAEL GESAS,
100 West Monroe Street,
Chicago, Illinois.
PAUL F. ARNOLD,
915 Old National Bank Building,
Evansville, Indiana.